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**UDC 657
JEL M41, F38**

THE AZERBAIJANI MODEL OF SETTING UP ACCOUNTING SYSTEM BASED ON THE INTERNATIONAL FINANCIAL REPORTING STANDARDS

Abstract

The article reflects on the process of establishing an accounting system in the Republic of Azerbaijan based on the IFRS in the context of the new economic environment, the approaches used, the problems in the practical application of the new system and ways to solve these problems.

Keywords: national accounting standards, methodology and practice of accounting, practical problems.

Introduction

In the context of economic globalization (we think that no pandemic can stop this process but can only change its speed, directions and forms), an increased role of financial statements requires reconsideration of various elements of accounting theory, practice and methodology. This necessity is observed in all countries which are pieces of world economic system because international flows of capital, material and labor resources create a need for the owners of these resources in continuous precise, correct and timely systematized information about the same resources.

Reconstruction, in other words, reforms of accounting has been continuing for more than 29 years in the independent Republic of Azerbaijan in terms of transition to the new economic system and change of business circumstances. However, neither objective full evaluation nor analysis of the results of this process have been implemented. Therefore, it is an important task to prepare forecasts about the current situation and subsequent development directions in the field of reforming accounting and reporting. Of course, it should be accepted that radical changes have been implemented in Azerbaijan to create normative-legal basis for accounting and reporting, however, unfortunately, these measures have not been realized with regard to the practical aspects, in other words, perfect accounting system has not been yet established and various forms are still being used.

As seen from the above, there is a need for the new methodological approach on accounting and this should enable to uncover the contents of various accounting types, to show their development process and unify them in one methodological point. This approach requires new view on the comparison and role of accounting theory, practice and methodology.

Purpose of the Study

The purpose of the article is to present an overview of the process of setting up the new national accounting system in Azerbaijan in accordance with the international standards by separately discussing two aspects (establishing legal framework and practical implementation) thereof to reveal the key challenges faced with regard to thoroughly applying the new standards in the practice and make recommendations on their solution.

Main Text

Developing methodological grounds of the national accounting system based on the IFRS: Azerbaijani model

One of the main problems in accounting is to change traditional approaches to acceptance, evaluation and reflection of capitals, assets, revenues and expenses as the information elements of a business unit's financial situation and activity. Assets, capitals, revenues and expenses must be understood in the same manner by the all participants of economic processes (legislators, managerial board, accounting department, tax authorities, scientists and etc.). In other words, there is a need for unification of these definitions.

From other side, it is necessary to separately consider methodology, because only an activity ensuring systematizing theoretical knowledge and practical skills logically related with each other can guide scientific values to current problem solutions [1]. Surely, development of the methodology as a practical activity area can happen only by adopting and applying accounting laws, national standards, chart of accounts, regulations and other normative documents as well as summarizing the results of such applying. In other words, methodology and regulatory framework ensure to systematize and evaluate practical implementation of fundamental theoretical knowledge on accounting, and naturally, this leads to a number of objective questions:

- If the regulatory frameworks are different in various countries, then are not there any generally accepted common standard on accounting (as in case of other sciences)?!
- Can or do the IFRS play the role of common standard in this area?
- How effective is the adopting national accounting standards and their adaptation to the IFRS?

- Should implementation of the IFRS cover the whole economy or only its part (for example, only companies listed on stock exchange or entities of public importance and etc.)?

Answers to these questions enable to express thoughts on formation of precise accounting information and whether this information is comparable or not in different countries. In other words, identity of methodological grounds stipulates existence of comparable economic information on financial (accounting) reports. Namely based on this the Law on Accounting was adopted in 2004 in Azerbaijan and the norms of the previous Law of 1995 concerning organization of accounting and forms of financial reports had not been inserted in the new Law [2]. The new law provided for reconstruction of national accounting system in our country in accordance with the most advanced practices worldwide. Adoption of the new law also gave start to the process of changing methodological grounds of accounting due to the change in the hierarchy of the regulating documents. The Decree of the President of the Republic of Azerbaijan on adoption of the Accounting Law determined exact functions and responsible areas of central executive authorities and other state regulative

bodies in the area of regulation of accounting and reporting. The main purpose was to achieve development of accounting system and transparency of financial reports on the basis of international financial (accounting) standards. It was planned to develop and implement the following in order to realize this purpose:

1) Applying the IFRS (with translation into Azerbaijani) and National Accounting Standards (NAS) as prepared on the basis of the IFRS in the commercial entities;

2) National Accounting Standards for non-commercial entities on the basis of the International Accounting Standards for the Public Sector (PSIAS).

Furthermore, according to the Law on Accounting [3], the Ministry of Finance as a central executive body implementing administration in the field of accounting had to:

- develop the NAS and recommendations on application of the NAS and the rules of maintaining accounting;

- give a consent to application of normative-legal acts and recommendatory documents of other executive bodies and off-budget state funds prepared within their authorities;

- develop and approve simplified accounting rules for small business entities;

- cooperate with professional accounting firms in the country to improve national accounting system.

As one can see, the Law permitted the organizations of specific profile to develop normative-legal acts and recommendatory documents relating to accounting. However, these acts and documents can be applied only with permission of the Ministry of Finance as the main regulating body in the field of accounting.

The Law also stipulates that the accounting rules, forms, contents and frequency of the financial reports for credit organizations shall be determined by the Central Bank of Azerbaijan but again can be applied with the permission of the Ministry of Finance.

At the same time, the Law on Accounting requires to establish Accounting Advisory Board in the country and obliges the Ministry of Finance to adopt accounting and financial reporting issues (especially, implementation of the IFRS and PSIAS) by advising with the Board.

Thus, the new Law reflected all main requirements and positive trends in the international practice of accounting and financial reports.

And this was enabling all business entities (commercial and non-commercial organizations and physical entities in accordance with the Civil Code of the Republic of Azerbaijan) operating in the country to form their accounting and financial reports pursuant to the advanced provisions of the new legislation.

For the purposes of exactly determining the requirements for preparation of financial reports, all commercial entities are divided into 3 groups: (1) commercial entities of public importance (credit organizations, insurance companies, investment funds, private pension funds, legal entities listed in stock exchange and enterprises included in the list of the entities approved by the Cabinet of Ministers based on their annual turnover, number of employees and balance sheet total that must maintain accounting and prepare financial reports under IFRS); (2) small business entities (legal entities with lower revenue turnover and being subject to simplified tax and physical entities); (3) other commercial entities (medium size enterprises not covered by the 1st and 2nd groups). And non-commercial entities are divided into 4 groups: (1) state budget organizations; (2) off-budget state funds; (3) municipal authorities; (4) non-government organizations.

As we can see, the Law covered all types of accounting subjects and provided for use of different accounting and financial reports standards to various categories of entities. We think

that this is the most correct approach in the practice of countries moving to the IFRS because applying adaptive standard to each category based on its capacity, public weight, the outside interest shown on it in the country and abroad is the mechanism that can ensure the highest efficiency.

Thus, in the process of preparation of new methodological grounds of accounting and reporting that took its start in 2005, 37 NAS were developed and adopted on the basis of the IFRS during 2007-2009. In addition, the Cabinet of Ministers of the Republic of Azerbaijan approved the following rules and regulations:

- “The Rules on forms, content and filing of annual financial statements of non-governmental organizations” dated 25 December 2009 [4];

- “The Rules on filing, reporting periods and publishing of financial statements of commercial organizations and consolidated financial statements” dated 27 May 2010 [5].

Along with the above documents, the Ministry of Finance approved the following rules and regulations:

- “The Rules on maintaining simplified accounting in small entrepreneurial entities” dated 13 January 2009;

- “The Instruction on organization and maintaining of accounting in state budget financed organizations in accordance with the national accounting standards for budget organizations” dated 9 February 2012;

- “The Rules on filing, reporting periods and publishing of financial statements of budget organizations and off-budget state funds” dated 15 April 2013;

- “The Rules on maintaining memorial order accounting form on the basis of the IFRS and the NAS” dated 18 January 2016;

- “The Rules on maintaining accounting on the basis of the IFRS and the NAS for commercial entities” dated 30 January 2017;

- “The Rules on maintaining accounting for the public sector on the basis of the IFRS” dated 25 December 2018;

- “The Rules on maintaining accounting for small and medium size commercial entities on the basis of the IFRS and the NAS” dated 9 December 2019 [6].

Accordingly, it may be considered that the methodological basis of accounting to accurately reflect all features of the economic environment in the country was adopted by the legislative and executive authorities. Of course, it is expedient to add to the above list also the normative-legal acts (“The Rules on maintaining accounting for credit organizations operating in the Republic of Azerbaijan” dated 11 November 2005, “Chart of Accounts and methodological instructions on its use for the bank system of the Republic of Azerbaijan” dated 25 December 2012, and additional 8 Rules) [7] adopted by the Central Bank of the Republic of Azerbaijan for regulation of accounting and reporting in the bank sector. Several authors who conducted an analysis of the Azerbaijani experience of formation of the new accounting system in the economic literature considered lack of some of the IFRS or the relevant NAS as a disadvantage of this process [2]. However, in our opinion, these authors would agree with us that the process has not yet finished and logically the absent standards shall be adopted with consideration of the national features as the economic environment and the necessity for them are formed (for example, NAS 32 on the first application of the National Accounting Standards was prepared on the basis of IFRS 1 or NAS 30 on the financial statements in hyperinflation was prepared on the basis of IFRS 29). Of course, adoption of all currently valid international standards (37 IAS and 16 IFRS) requires certain

time during which the necessary economic grounds (environment) are being formed. In other words, we think that the process of preparation of the methodological grounds of the accounting system in the Republic of Azerbaijan in accordance with the international standards can be assessed as a good practice. But the question is why practical implementation of these methodological grounds is not so fast and efficient (this should consider such a nuance that the Ministry of Finance, a regulating body in Azerbaijan in the field of accounting in accordance with the IFRS requirements, does not hold control over maintaining accounting in business entities)?

The key challenges in practical implementation of the new accounting system

The following may be attributed to the problems that are currently arising in connection with practical implementation of accounting under the IFRS:

- lack of opportunities to use integrated automatized systems of financial and tax accounting in the field;
- low level of real transition of enterprises to the IFRS (even the new chart of accounts is not being used by the majority of enterprises);
- observing the fact that human resources with higher education specialized in accounting are not meeting the requirements of the contemporary economy and labor market and have to apply for additional chargeable accounting courses;
- lack of simple algorithm of automatized preparation and analysis of accounting reporting;
- although the necessity for the transition of the consolidated financial statements to the IFRS has been established for some business entities, yet a small number of organizations meet this requirement (for example, bank system, SOCAR, Azercell and etc.), most closed joint stock companies have not yet solved this problem.

Solvency of all these problems have a complex nature and reveals the truth that existence of a long period between creation of legal framework and its practical implementation is explicitly reflected in the process of setting up accounting system. Of course, we understand the impossibility of immediate moving by all enterprises (organizations) to the IFRS and as well we do not support this. This process should take into consideration such factors like circumstances and formation of available material and personnel base. However, at least enterprises with international economic relations, joint enterprises, stock companies, insurance companies and etc. should move to the IFRS. Such a transition may be not so important for municipal authorities, state budget financed organizations as well entities with no access to the international markets. At the same time, separate point of view should be formed with regard to the use of the IFRS by small business entities. It should be considered that accounting practice of big enterprises reveals a number of risks, specific circumstances, deemed assets and liabilities and other similar economic processes that we have never faced before. And this in its turn requires presence of the IFRS in order to express adequate response. Applying the IFRS brings up to the agenda reevaluation of the purposes of accounting reporting, that is requires change of the thorough conceptual nature of accounting. From this point of view, it is understandable to have in the new chart of accounts accounting objects like intangible assets, financial investments, lease liabilities, tax liabilities. Simultaneously, increase in quality of the information reflected in the accounting and reporting and ensuring access to this information for all interested parties are the main directions of the development of accounting and reporting. Before, as we noted,

reforms in the accounting field in our country have been realized to adapt it to the IFRS by establishing relevant normative-legal framework (main attention was directed to the accounting reporting rather than accounting process, adopted national accounting standards in accordance with the international standards), issuing methodological instructions and strengthening international cooperation. In our opinion, the last element of this process which is the preparation of the personnel with accounting and audit specialization meeting the new requirements in some way lags behind the other directions, and this opinion is supported by the current need in the labor market for the accountants who are able to maintain accounting under the new national standards and to connect financial accounting and tax accounting. Broader implementation of the IFRS in our country makes it of special importance to prepare qualified accounting personnel because applying the IFRS increases the quality of management reporting, attracts investors, broadens external debt (credit) opportunities as well meets more requirements of shareholders.

Thus the main problems of development of accounting in Azerbaijan can be as follows:

- extending the scope of applying national accounting standards prepared in accordance with the IFRS;
- establishing financial accounting and tax accounting in each enterprise in a parallel manner and complementing each other;
- preparation of accounting reporting in an understandable, comparable, transparent, confident manner and less expensive for analysis;
- preparation of personnel with accounting specialization who can ensure applying IFRS and correctly determine accounting policy of an enterprise.

Timely and efficient solving of these problems could help in establishing accounting system in Azerbaijan on the new grounds and formation of its reliable relations with the international community.

The requirements with regard to the accounting information like timely registering, objectivity, accuracy, compliance, reliability, comparability, correctness that took place before are not sufficient in the modern conditions of economic development and the more important problem becomes the role of such information for the purposes of planning, forecasting, analysis and control, that is meeting the requirements of the internal and external users for making efficient management, investment and other decisions. In other words, the increased requirements on accounting information objectively requires changing the functional directions of accounting and its transformation from an instrument for registering business transactions to an instrument for improvement of enterprises' business activity policy. Therefore, accounting should be organized in every business entity so that it could provide thorough and correct information about the same entity's activity. Naturally, the organization of accounting is strongly affected by both external (the requirements of legal acts on organization of accounting, bookkeeping for assets, capital and liabilities, preparation of financial statements and etc.) and internal (the requirements of the management and accounting department of an enterprise on the structure and content of the information, the requirements of the internal audit concerning this information, relevance of the expenses on formation of accounting information and etc.) factors. These factors as well the elements of the conceptual grounds of organization of accounting (forms, principles, subsystems, organizational structure, techniques and technologies of accounting, accounting policy of the enterprise, internal control system) determine efficiency of establishing and maintaining accounting in each business entity as a whole.

Conclusion

Based on the analysis in the present article, in our opinion, the process of preparation of the methodological grounds of the new accounting system in Azerbaijan in accordance with the international standards should be characterized as a good experience. However, it is also our conclusion that there are a number of problems to be solved to facilitate the rapid progress of the practical implementation of these methodological grounds. At present, we think that in order to achieve practical application of IFRS, the mechanism of organization of accounting in enterprises can be improved in the following areas:

- 1) improvement of organizational structure of accounting;
- 2) development of technology of accounting information processing;
- 3) improvement of accounting policy;
- 4) increasing efficiency of internal control system.

As evidenced from the above, development of theoretical issues, normative-legal framework of accounting as well methodological support of the accounting process and practical organization of accounting in response to the new requirements is one of the important tasks on the agenda.

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Məqalə redaksiyaya daxil olmuşdur:
20.02.2020
Təkrar işləməyə göndərilmişdir:
04.03.2020
Çapa qəbul olunmuşdur: 18.03.2020

Дата поступления статьи в редакцию: 20.02.2020
Отправлено на повторную обработку: 04.03.2020
Принято к печати: 18.03.2020

The date of the admission of the article to the editorial office: 20.02.2020
Send for reprocessing: 04.03.2020
Accepted for publication: 18.03.2020